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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

AMERICAN FINANCIAL SERVICES ASSOCIATION,

Petitioner,

v.

FEDERAL TRADE COMMISSION, *et al.*,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTIONS PRESENTED

Section 5(a)(1) of the Federal Trade Commission Act declares that "unfair" acts or practices in or affecting commerce are unlawful, and Section 18(a)(1)(B) empowers the Federal Trade Commission to issue rules of general applicability defining acts or practices that are "unfair" within the meaning of Section 5(a)(1) and prescribing requirements for the purpose of preventing such acts or practices. Invoking this authority, the FTC promulgated a rule forbidding consumers to obtain credit by pledging certain property — household goods and future earnings — as collateral; it did this by defining it to be an "unfair" act or practice under Section 5(a)(1) for lenders to accept such pledged property as collateral.

The questions presented are:

1. May the FTC define an act or practice as "unfair" under Section 5(a)(1) in the absence of seller overreaching or other interference with free and informed consumer choice, simply because it considers particular consumer decisions unwise?

2. May the FTC prescribe rules under Section 18(a)(1)(B) that sweep far beyond the prevention of the commercial abuses identified in the rulemaking record, or, as the Second Circuit has held, must such rules be narrowly tailored to remedy those abuses?

3. Is the FTC authorized by Section 18(a)(1)(B) to prescribe rules that preempt more narrowly tailored state consumer-protection laws that effectively guard against the very injuries targeted by the FTC's rules?

PARTIES BELOW

The parties to the consolidated proceedings in the Court of Appeals included petitioners American Financial Services Association (No. 84-1081) and South Carolina Department of Consumer Affairs (No. 84-1167); respondent Federal Trade Commission; intervenor-petitioner American Conference of Uniform Consumer Credit Code States; and intervenors-respondents Silas Brown, the National Consumer Law Center, and Community Thrift Clubs, Inc.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioner American Financial Services Association seeks review of a 2-1 decision of the Court of Appeals upholding a Federal Trade Commission rule governing consumer credit practices — the Credit Practices Rule. The rule, issued on March 1, 1984, took effect on March 1, 1985.

OPINION BELOW

The opinion of the Court of Appeals (set forth as Appendix A hereto) is reported at 767 F.2d 957. The FTC's Credit Practices Rule (set forth as Appendix B hereto) is codified at 16 C.F.R. Part 444. The FTC's statement of the rule's basis and purpose (Appendix C) is published at 49 Fed. Reg. 7740 (1984).[1]

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[1] The appendices to this petition, cited as "Pet. App." herein, are separately bound.

JURISDICTION

The judgment of the Court of Appeals was entered on July 12, 1985. On October 1, 1985, the Chief Justice extended the time in which to petition for certiorari from October 10 to November 9, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

U.S. Const., Art. I, § 1:

> "All legislative Powers herein granted shall be vested in a Congress of the United States . . . ."

Federal Trade Commission Act —

§ 5(a)(1), 15 U.S.C. § 45(a)(1):

> "Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are declared unlawful."

§ 18(a)(1)(B), 15 U.S.C. § 57a(a)(1)(B):

> "(1) . . . the Commission may prescribe —
>
> . . .
>
> (B) rules which define with specificity acts or practices which are unfair or deceptive acts or practices in or affecting commerce (within the meaning of section 45(a)(1) of this title) . . . . Rules under this subparagraph may include requirements prescribed for the purpose of preventing such acts or practices."

STATEMENT OF THE CASE

This case concerns the scope of the FTC's power under Section 5(a)(1) of the Federal Trade Commission Act to define acts or practices as "unfair" and to fashion trade regulation rules under Section 18(a)(1)(B) for the purpose of preventing such acts or practices. At issue are two provisions of a trade regulation rule — the Credit Practices Rule — which bar consumers from obtaining credit by pledging certain personal property ("household goods" and future earnings) as collateral. The rule accomplishes this by declaring it to be an "unfair" act or practice under Section 5 for a lender, in extending credit to a consumer, to take or receive a nonpurchase money, nonpossessory security interest in household goods or an irrevocable assignment of future earnings. These two provisions of the rule are described at pages 8-10, below.

Petitioner American Financial Services Association is a trade association of more than 550 consumer finance and small-loan companies, the consumer lenders that are principally affected by the Credit Practices Rule and, particularly, by the two challenged provisions of the rule. AFSA contends that the FTC's ban on the use of household goods and future earnings as collateral in consumer credit transactions is an impermissible exercise of the agency's powers — an attempt by the FTC to "protect" consumers from purchasing decisions it merely considers unwise, and to force the market to offer goods and services either at a price the agency considers reasonable or not at all. As Judge Tamm wrote in dissenting from the Court of Appeals' decision (see pp. 14-15, below), for an act or practice to be deemed "unfair" under Section 5, it must be found to interfere with free and informed consumer choice, and the FTC made no such finding here. Congress did not intend to give the FTC open-ended power to promote its own vision of consumer welfare in the name of extirpating "unfair" acts or practices.

1. The Statutory Framework.

Section 5(a)(1) of the Federal Trade Commission Act, 15 U.S.C. § 45(a)(1), declares that "unfair or deceptive acts or practices in or affecting commerce" are unlawful. The Act nowhere defines what constitutes "unfair" acts or practices; this Court has referred to the "elusive, but congressionally mandated standard of fairness." *FTC* v. *Sperry & Hutchinson Co.*, 405 U.S. 233, 244 (1972).[2] Both on the face of the phrase and in practice, "unfair . . . acts or practices" *is* a more elusive concept than the phrases that are its companions in Section 5(a)(1).

As enacted in 1914, Section 5 reached only "unfair methods of competition." 38 Stat. 719. Though not restricted to violations of the antitrust laws or antitrust principles, see *FTC* v. *R.F. Keppel & Bro., Inc.*, 291 U.S. 304 (1934), the term "unfair methods of competition" is nevertheless commonly thought of as marking out, and doing so with fair certainty, that part of the FTC's antitrust jurisdiction that does not rest on specific provisions of the Clayton Act. The Wheeler-Lea Amendments of 1938 added "unfair or deceptive acts or practices" to the conduct that Section 5 makes unlawful, 52 Stat. 111, confirming the broad *Keppel* reading of the section and making "it clear that Congress . . . charged the FTC with protecting consumers as well as competitors." *Sperry & Hutchinson*, 405 U.S. at 244.

In the exercise of its specifically consumer-protection jurisdiction beginning in 1938, the FTC proceeded almost exclusively case by case, through cease-and-desist order proceedings. In such proceedings, the FTC rarely relied on its authority to combat "unfair" acts or practices as an independent basis for enforcement, perhaps because of the inherent difficulty of defining "unfairness" with any precision. As late as 1972, it took this Court's decision in *S&H* to establish that Section 5 unfairness was not limited to violations of the letter

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[2] See also *Atlantic Refining Co.* v. *FTC*, 381 U.S. 357, 367 (1965); *FTC* v. *R.F. Keppel & Bro., Inc.*, 291 U.S. 304, 310-12 (1934).

or spirit of the antitrust laws. When unfairness was invoked by the FTC as a ground for proceeding, it was typically as an alternative or additional ground along with deception. (See Pet. App. 23a n.15, 39a)

In 1975, Congress added Section 18(a)(1)(B) to the Act, expressly authorizing the FTC to make binding trade regulation rules of general applicability defining "with specificity" acts or practices that are "unfair" or "deceptive" within the meaning of Section 5(a)(1) and prescribing "requirements . . . for the purpose of preventing such acts or practices." 15 U.S.C. § 57a(a)(1)(B).[3] As the FTC intensified its consumer-protection activity in the wake of the enactment of the Magnuson-Moss Act, it began to rely on its authority to prohibit "unfair" acts or practices as an independent basis for regulation, and, as the court below noted, "considerable controversy" developed over the agency's exercise of this power. (Pet. App. 18a-19a, 38a-39a)

To answer congressional concern over the scope of this power, the FTC in 1980 issued a Policy Statement giving its authoritative interpretation of what commercial activity might properly be prohibited as "unfair." The FTC stated that, for an act or practice to be proscribed as "unfair" under Section 5, the act or practice must cause substantial "consumer injury," the injury must be one that consumers cannot "reasonably avoid," and the injury must not be outweighed by offsetting consumer or competitive benefits that the act or practice also produces. (Pet. App. 287a-290a)[4] This Statement was described below as a "refinement" of the FTC's earlier description of the standard it applied in determining whether a practice that is neither in violation of the antitrust laws nor deceptive is nonetheless "unfair to consumers" — a

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[3] Magnuson-Moss Warranty-Federal Trade Commission Improvements Act, Pub. L. No. 93-637, title II, § 202(a), 88 Stat. 2193 (1975).

[4] Letter from FTC to Senators Ford and Danforth, Dec. 17, 1980, pp. 5-7, set forth as Appendix D hereto. See also Letter from FTC to Senators Packwood and Kasten, March 5, 1982, the pertinent portions of which are set forth as Appendix E hereto.

standard that had placed primary emphasis on whether the practice in question offended "public policy" as embodied in "some common law, statutory, or other established concept of unfairness." (See Pet. App. 22a) (quoting earlier standard).[5]

The FTC has stated that the three-part test of the 1980 Policy Statement reflects its long-established approach to identifying and prohibiting "unfair" acts or practices. (Pet. App. 284a) The commercial activity that has been proscribed under this approach has typically involved some form of seller overreaching or other interference with "free and informed" consumer choice (Pet. App. 290a-291a); the FTC thus emphasized that its power to proscribe "unfair" acts or practices does *not* entitle it to "second-guess the wisdom of particular consumer decisions, but rather to halt some form of seller behavior that unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decision-making." (Pet. App. 290a) The FTC stressed its reliance on —

> "consumer choice — the ability of individual consumers to make their own private purchasing decisions without regulatory intervention — to govern the market. We anticipate that consumers will survey the available alternatives, choose those that are most desirable, and avoid those that are inadequate or unsatisfactory." (Pet. App. 289a-290a)

The FTC has since reaffirmed that its exercise of its power to attack "unfair" acts or practices should be confined to "behavior that takes unfair advantage of consumers' inadequate knowledge or inability to protect themselves from such behavior." (Pet. App. 308a) Until this case, it had never intimated that the unavailability of a product at a price the agency considers reasonable might be treated as "an obstacle to the free exercise of consumer decisionmaking"; that having

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[5] The FTC noted in its 1980 Policy Statement that this Court had cited that standard, first enunciated in 1964, with apparent approval in its *S&H* opinion, 405 U.S. at 244-45 n.5. See Pet. App. 22a-23a.

to purchase a product at a price the agency considers too high might be deemed a source of consumer "injury"; or that not being able to purchase the product at a *lower* price might be held to make the supposed consumer injury not "reasonably avoidable."[6]

2. The Credit Practices Rule.

The Credit Practices Rule, issued by the FTC on March 1, 1984, was the culmination of a rulemaking proceeding that began in April 1975, soon after the Magnuson-Moss Act took effect. The Credit Practices Rule applies principally to finance companies but also to credit unions and merchants to the extent that they extend credit. As required by Section 18(f)(1) of the Act, 15 U.S.C. § 57a(f)(1), the Federal Reserve Board and the Federal Home Loan Bank Board have promulgated substantially similar rules applicable to banks and savings and loan institutions, respectively[7]; but those most affected by the rule are the low-income, high-risk consumers who depend on consumer finance and small-loan companies for credit.

Substantially more modest than it was as originally proposed ten years ago, the FTC's rule imposes a variety of restrictions on consumer credit transactions. The rule includes prohibitions on the inclusion in consumer credit con-

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[6] The FTC's exercise of its Magnuson-Moss rulemaking power has thus far met with mixed results. Two of the four trade regulation rules of which judicial review has been sought have been invalidated in whole or in part. *Katharine Gibbs School (Inc.)* v. *FTC*, 612 F.2d 658 (2d Cir. 1979) (rule governing vocational school sales and enrollment practices); *American Optometric Ass'n* v. *FTC*, 626 F.2d 896 (D.C. Cir. 1980) (rule governing advertising of eye examinations and ophthalmic goods and services). One — apart from the Credit Practices Rule — has been sustained. *Harry & Bryant Co.* v. *FTC*, 726 F.2d 993 (4th Cir.) (rule governing sales practices of funeral industry), *cert. denied*, 105 S. Ct. 91 (1984).

[7] Federal Reserve System, *Final Rule*, 50 Fed. Reg. 16,695 (1985) (to be codified at 12 C.F.R. Part 227); Federal Home Loan Bank Board, *Final Rule*, 50 Fed. Reg. 19,325 (1985) (to be codified at 12 C.F.R. Part 535).

tracts of confessions of judgment[8] and advance waivers of statutory exemptions of certain property from execution[9]; requirements that a creditor not misrepresent a cosigner's liability on a consumer loan and that the creditor inform the co-signer of his potential liability before he assumes it[10]; a prohibition of "pyramiding" late charges[11]; and the two provisions of the rule whose legality is challenged by AFSA in this case. These last two provisions — resting solely on the FTC's power to proscribe "unfair" acts or practices — have been modified somewhat in their substance from what was proposed; but they remain the broadest possible prohibitory "relief" from whatever it is that the FTC considers "unfair" in the use of household goods and future earnings as collateral.

(a) The Household Goods Rule.

Section (a)(4) of the rule (codified as 16 C.F.R. § 444.2(a)(4)) forbids a consumer to obtain a loan by pledging as collateral certain personal property defined as "household goods," unless the loan is obtained in order to purchase the very property in which a security interest is given. (Pet. App. 83a-84a)[12] The rule does this by declaring it to be an "unfair" act or practice within the meaning of Section 5(a)(1) for a lender to take or receive "a nonpossessory security interest" in such property, "other than a purchase money security interest." Thus, under the rule, a consumer who borrows

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[8] 16 C.F.R. § 444.2(a)(1) (discussed at Pet. App. 122a-147a).

[9] 16 C.F.R. § 444.2(a)(2) (discussed at Pet. App. 199a-209a).

[10] 16 C.F.R. § 444.3 (discussed at Pet. App. 217a-237a).

[11] 16 C.F.R. § 444.4 (discussed at Pet. App. 209a-217a).

[12] The definition of "household goods" is set forth at 16 C.F.R. § 444.1(i) (Pet. App. 82a-83a). Although the FTC stated that "the purpose of the rule" is to prevent consumers from pledging "those household goods which constitute necessities" (Pet. App. 195a), its definition of "household goods" is in fact appreciably broader, and the rule applies regardless of the borrower's financial circumstances. The FTC found, and conceded in the court below, that household goods pledged as collateral are in fact "rarely" seized, even in the event of default. (Pet. App. 178a; *id.* at 74a n.6 (Tamm, J., dissenting))

$1,000 to buy a dishwasher may pledge the dishwasher to secure the loan, but he may not pledge the dishwasher to secure a $1,000 loan to fix the front porch. Because the rule applies only to *nonpossessory* interests, the consumer may leave his wedding ring or watch (defined as "household goods" under the rule) with a pawnbroker to raise quick cash, but he may not give a finance company a piece of paper pledging the same items as collateral to secure a loan.

The challenged rule forbids consumers to secure credit by pledging household goods as collateral, but it does not require lenders to extend credit to anyone — even though the FTC found that the use of such pledged collateral to secure credit was "widespread" (Pet. App. 174a), and even though the FTC's Presiding Officer reported that the rule would "undoubtedly have a very considerable impact . . . upon the availability of credit to consumers." (See Pet. App. 77a) Nor does the rule remove state interest rate ceilings or other common law or statutory restrictions, which prevent lenders from increasing the cost of credit to offset any increased risk of delinquency or default resulting from the rule's limitation on a consumer's ability to collateralize a loan. If a particular consumer's access to credit depends on his ability to secure the loan by pledging household goods as collateral, the result of the rule is to place credit beyond his reach. Finance companies are the primary source of credit for consumers who have no other collateral to pledge and cannot qualify for unsecured loans; such consumers are considered to be "higher risk borrowers." (Pet. App. 248a n.13)

(b) The Future Earnings Rule.

Section (a)(3) of the rule (codified as 16 C.F.R. § 444.2(a)(3)) restricts a consumer's ability to obtain a loan by pledging future earnings as collateral. (Pet. App. 83a-84a)[13] Specifically, the rule *permits* a consumer to secure credit by agreeing to repay the loan through payroll deductions or

[13] The definition of "earnings" is set forth at 16 C.F.R. § 444.1(h) (Pet. App. 82a). It includes not only wages and salary but also "periodic payments pursuant to a pension, retirement, or disability program."

other prearranged payment plans; but it *forbids* the consumer to secure credit by agreeing to repay the loan with future earnings in any *other* way. Although the principal asserted basis for the restriction is to protect employment relationships from unwarranted disruption (see Pet. App. 157a-161a), the FTC's restriction applies not only to future wages and salaries but also to pension, retirement, and disability payments. (Pet. App. 82a) The rule permits a consumer to pledge or "assign" such future earnings as collateral only if he retains the right to revoke the pledge at will.

Like the ban on the use of household goods as collateral, the restriction on the use of future earnings primarily affects customers of consumer finance and small-loan companies. (Pet. App. 154a-155a) The FTC saw fit to promulgate the restriction even though the agency's Presiding Officer reported that the result would be that "low-income consumers would be deprived of access to credit,"[14] and even though the only two states in which the use of future earnings as collateral is common — Illinois and New York — stringently regulate the use of the device known as the wage assignment so as to prevent the very consumer "injuries" at which the FTC's restriction is aimed. See pp. 23-24, below. As with the FTC's ban on the use of household goods as collateral, its restriction on a consumer's use of his future earning power to obtain a loan is cast as a restriction on "unfair" creditor conduct — defined here as taking or receiving a consumer's irrevocable assignment of future earnings as collateral. No lender is *required* to make loans to consumers who would otherwise qualify for credit only on the basis of their ability to pledge future earnings.

The FTC's justification for restricting the use of household goods and future earnings as collateral in consumer credit transactions was, at bottom, quite simple. The FTC concluded that the loss of such property in the event of default — indeed, the very *thought* of losing such property — is so painful to consumers that they should not be permitted

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[14] Presiding Officer's Report 123; see Pet. App. 163a.

to risk that pain by pledging such property as loan collateral.[15] In the FTC's view, the potential pain to consumers outweighs any potential gain (see Pet. App. 33a); it concluded that the market had failed to offer a mix of credit options that sufficiently indulged "borrower preferences." (Pet. App. 111a; see also *id.* at 34a, 45a) In a "well-functioning market," the FTC postulated, consumers would not *have* to pledge household goods or future earnings to obtain credit. (Pet. App. 111a)

To fit this justification within its established three-part test for finding an act or practice "unfair" within the meaning of Section 5, the FTC first purported to find that having to *risk* this pain constitutes substantial "consumer injury." (Pet. App. 177a-187a; 157a-162a) The FTC next concluded that consumers could not "reasonably avoid" this injury because they lack the incentive to shop for or demand credit on more favorable terms and lenders lack the incentive to compete for business by offering consumers easier credit. (Pet. App. 104a) Finally, the FTC reasoned that restricting the use of household goods or future earnings as collateral would not adversely affect the price or availability of credit because, in its view, such collateral has no legitimate economic utility but serves lenders solely as a means of browbeating delinquent borrowers. (See Pet. App. 27a-29a, 30a-31a)

In promulgating its rule, the FTC made *no* finding that consumers either pledge household goods as collateral or make wage assignments without knowing that they are doing

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[15] Despite its repeated intimations that repossession of household goods would leave borrowers destitute, the FTC found that a substantial portion of borrowers who pledge household goods as collateral do so for home improvements, "suggesting that the borrowers were homeowners and therefore may have had other assets to pledge as security." (Pet. App. 188a) The FTC made this revealing observation in justifying its conclusion that banning the use of pledged household goods as collateral would not deny borrowers access to credit; in stressing the supposed hardship of repossession, however, it managed to ignore this evidence. (See Pet. App. 77a-78a (Tamm, J., dissenting))

so or without an awareness of what doing so might entail. It made *no* finding that creditors commonly or even occasionally deceive consumers with respect to either the fact or the extent of their undertaking, or that consumers act with incomplete information. And it made *no* finding that creditors somehow coerce consumers into obtaining loans by pledging household goods or future earnings as collateral.[16] Apart from some isolated instances of abusive debt collection practices that a far narrower rule could prevent, the only "wrongdoing" on the record in these proceedings was the refusal of some lenders to give some consumers a "better deal" — that is, to extend credit without requiring that such consumers pledge household goods or future earnings as collateral. The only "injury" on this record (apart from any injuries occasioned by the abusive debt collection practices) was the hardship that may befall a consumer who chooses to obtain credit on the terms available despite the risks.

3. Proceedings In the Court Below.

AFSA, joined by the South Carolina Department of Consumer Affairs (and supported by the American Conference of Uniform Credit Code States and two *amici*),[17] challenged the household goods and future earnings provisions of the Credit Practices Rule in the Court of Appeals, pursuant to Section 18(e)(1)(A), 15 U.S.C. § 57a(e)(1)(A). AFSA argued that these provisions of the rule represent nothing more than a paternalistic *pricing* decision by the FTC — a determination that the hardships risked by a consumer who pledges household goods or future earnings as loan collateral are simply too high a price to pay for credit. AFSA argued that the FTC's attempt to establish a "just price" for credit was an imper-

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[16] As Judge Tamm noted, the FTC found that the overwhelming majority of loan contracts (90%) specify the household goods pledged as collateral, and that consumers generally understand the consequences of default. (Pet. App. 70a & n.3; *id.* at 175a-176a)

[17] The two *amici* supporting petitioners were the National Association of Consumer Credit Administrators and the Mississippi Commissioner of Banking and Consumer Finance.

missible exercise of its statutory authority to define and prevent "unfair" acts or practices, inconsistent with the agency's Policy Statement and its prior practice; and AFSA argued that, construed to vest the FTC with such open-ended power to promote its own vision of consumer welfare in the name of fighting "unfairness," Sections 5(a)(1) and 18(a)(1)(B) would violate "the doctrine against uncanalized delegations of legislative power." *Industrial Union Department* v. *API*, 448 U.S. 607, 675 (1980) (Rehnquist, J., concurring in the judgment); see *id.* at 646 (plurality opinion) (disfavoring such constructions).

AFSA also argued that, to the extent that the FTC had identified abusive debt collection practices associated with the use of household goods or future earnings pledged as collateral, the rule's wholesale restrictions on the use of such property as collateral constituted an overbroad remedy, lacking a "reasonable relation to the unlawful practices found to exist." *Jacob Siegel Co.* v. *FTC*, 327 U.S. 608, 613 (1946). AFSA argued that such a sweeping exercise of the FTC's rulemaking powers under Section 18(a)(1)(B) was precluded by the Second Circuit's decision in *Katharine Gibbs School (Inc.)* v. *FTC*, 612 F.2d 658 (2d Cir. 1979), which held that Section 18(a)(1)(B) does *not* authorize the FTC to combat unfair acts or practices by promulgating broad prophylactic rules. AFSA also argued that, because of its broad sweep, the future earnings rule gratuitously — and therefore impermissibly — preempted carefully wrought consumer-protection statutes that allow pledges of future earnings under close regulation. These state statutes, AFSA pointed out, already guard against the very consumer "injuries" with which the FTC was concerned.

A divided panel of the D.C. Circuit sustained the rule. Writing for herself and Judge Edwards, Judge Wald noted that Congress had given the FTC no standards by which to identify acts or practices as "unfair" under Section 5(a)(1). (Pet. App. 15a, 18a) While acknowledging that the FTC "is hardly free to write its own law of consumer protection" (Pet.

App. 16a), she confessed that "[t]he broad delegation of discretionary authority to the FTC to define unfair practices makes our task particularly difficult in this case." (Pet. App. 18a) In the absence of any statutory boundary on the FTC's power to define "unfair" acts or practices, the majority elected to determine the validity of the FTC's actions by reviewing the reasonableness of the agency's application of the three-part "unfairness" test stated in its 1980 Policy Statement to the facts of this case, "and the consistency of that application with congressional policy and prior Commission precedent." (Pet. App. 25a)

Although the majority recognized that the FTC's Policy Statement does not approve the agency's intervention in the marketplace merely because "it believes the market is not producing the 'best deal' for consumers" (Pet. App. 46a), the majority accepted the FTC's stated rationale for its rule. The majority recapitulated the FTC's reasoning and pronounced it "reasonable." The majority found that the FTC had reasonably concluded that the use of household goods and future earnings as collateral was "unfair" within the meaning of the agency's three-part test, and that the agency's application of the test was unusual but not utterly without analogy. (Pet. App. 26a-49a; *id.* at 39a) It concluded that the rule was neither overbroad nor an impermissible exercise of preemptive power. (Pet. App. 49a-65a)

Judge Tamm dissented, condemning the FTC's rule as being "in excess of its statutory authority to regulate unfair trade practices." (Pet. App. 66a) In Judge Tamm's view, the rule reflects "a simple, paternalistic judgment" — that "those whose access to credit depends upon the pledge of meager household goods and future earnings would be better off if creditors were unable and unwilling to extend to them credit." (Pet. App. 79a) The FTC, he wrote, had failed to identify any marketplace impediment to the exercise of free and informed consumer choice; while purporting to find "unfairness" under its 1980 criteria, the agency had actually undertaken to implement a hidden "agenda," couching its

"paternalistic judgment" in terms of market failure and cost-benefit analysis "with enough skill to sneak past a court anesthetized by a misplaced deference to agency authority." (Pet. App. 80a-81a) "It is not [any] obstacle to free choice that the Commission wishes to prevent," Judge Tamm wrote, "but the free exercise thereof." (Pet. App. 80a)

REASONS FOR GRANTING THE WRIT

The substantive power to outlaw a business practice by declaring it "unfair," coupled with the procedural power to make such a decision applicable industry-wide, gives the FTC a mighty weapon indeed. Here the FTC has wielded its weapon by decreeing an end to two means that have enabled thousands upon thousands of people — the kind of people, typically, who are not eligible for bank loans — to borrow the money they needed or wanted. The decision of the Court of Appeals sustaining this exercise of the FTC's power under Section 5 and the Magnuson-Moss Act raises three important questions that should be answered by this Court.

The first is whether there are judicially enforceable limits to the "unfairness" power of the FTC under Section 5 and, if so, what they are. The majority below professed to discern in the 1980 Policy Statement limits that were not exceeded by the FTC, but it is hard to escape Judge Tamm's dissenting view of "a court anesthetized by a misplaced deference to agency authority." (Pet. App. 80a-81a) Unfairness has been found here in the operation of the competitive market for credit because some lenders ask for some special undertakings from high-risk would-be borrowers, and the result of those undertakings may be, for a tiny number of borrowers, to add to the pain and unpleasantness of falling behind in one's loan payments in the face of adversity. If the FTC may for that reason act to make it illegal for borrowers to insist on the undertakings (and thereby prevent would-be borrowers knowingly from making them), there is no effective limit to the FTC's unfairness power, and we have an uncanalized delegation of the power to legislate.

The second question is whether the FTC has misused its Magnuson-Moss rulemaking power by proscribing altogether commercial activity that, on the rulemaking record, sometimes gives rise to abusive practices, rather than by proscribing the abusive practices themselves. The decision below upholding the FTC is in conflict on this point with the decision of the Court of Appeals for the Second Circuit in *Katharine Gibbs School (Inc.)* v. *FTC*, 612 F.2d 658 (2d Cir. 1979). Taking the record in this case at full face value, it shows, in the case of household goods (and, to a much lesser extent, future earnings), that the holding by a lender of a security interest in such property enables him to engage in some heavy-handed debt collection practices; at least some of what the FTC has defined as household goods are necessities, and a threat to seize them surely could be unsettling. But under the Magnuson-Moss Act as it was construed in *Katharine Gibbs*, evidence of such abusive debt collection practices would justify a trade regulation rule aimed at those practices — *not* the wholesale banning of household goods security.

The third question is whether — in particular relation to the future earnings rule — the FTC has acted without proper regard for the efforts of the states, which remain primarily responsible for consumer protection, to accommodate the borrowing needs of people without assets other than their earning power. The few states where such people are permitted to assign their wages as security for a loan have legislated against the very evils that the FTC associates with wage assignments; as Judge Tamm observed, "the practice is already thoroughly regulated in the states where it is commonplace." (Pet. App. 73a n.4) The FTC has insisted nevertheless on altogether outlawing wage assignments because state law "does not *always* offer adequate protection" against the specific hardships the agency identified. (Pet. App. 153a) (emphasis added). Its action raises a serious issue of the way legislative powers are supposed to be divided between state and nation under the Magnuson-Moss Act.

1. The scope of the FTC's power to define an act or practice as "unfair" within the meaning of Section 5(a)(1) is a question of indisputable national importance. See Sup. Ct. R. 17.1(c). As the Court of Appeals was constrained to acknowledge, Congress has itself provided no meaningful guidance (Pet. App. 18a-21a); indeed, the court noted that "the most Congress has done to constrict the FTC's authority to make unfairness determinations is to impose special procedural requirements." (Pet. App. 15a n.9) Accordingly, the scope of the FTC's power has become a source of "considerable controversy." (Pet. App. 18a-19a & n.10, 38a-39a) This is a fitting case in which to delineate the outer boundaries of the FTC's power; indeed, it is difficult to imagine a case in which the need for judicial delineation of those boundaries would be more compelling.

Here, the FTC has intervened in the market in the absence of any finding of seller misconduct or other interference with free and informed consumer choice — the conventional touchstone of "unfairness" under Section 5. The provisions of the Credit Practices Rule challenged here rest instead on the FTC's view that credit should be available to consumers at "the right price," as the agency sees it — or not at all. It is the unavailability of credit to some consumers on easier terms that led the FTC to conclude that the market was not properly functioning. (See Pet. App. 34a). Its view is that would-be borrowers should not be *allowed* to pay the price of pledging household goods or future earnings as security because of the risks entailed, even if that means no loan or a smaller loan than they wanted.[18]

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[18] In accepting the FTC's conclusion that restricting the use of household goods as collateral would "have only a marginal impact on the cost or availability of credit" (Pet. App. 33a), the court's majority mirrored the FTC's inconsistent, result-driven logic. On the one hand, the FTC rejected the view of its Bureau of Economics that, even though household goods are worth little to a lender in the event of a borrower's default, the borrower's willingness to pledge such subjectively valuable property "signals" the lender that the borrower is credit worthy. (See Pet. App. 57a n.37) At the same time — tacitly accepting the "signalling" function of pledged house-

(footnote cont'd)

The challenged provisions are thus a paradigm of what Robert Reich, the former director of the FTC's Office of Policy Planning and Evaluation, has called "paternalistic government efforts to protect consumers from the consequences of their own appetites" — an approach that Mr. Reich described as "fundamentally incompatible with the liberal assumption that each person is the best judge of his or her own needs." Reich, *Toward a New Consumer Protection*, 128 U. Pa. L. Rev. 1, 20, 14 (1979). We submit that Congress never envisioned that Section 5(a)(1) would be deployed in such a manner, to regulate commercial activity where no seller overreaching or other interference with free and informed consumer choice is involved.

The FTC's paternalistic assertion of power is at odds not only with its own interpretation of its Section 5 authority, but also with "the doctrine against uncanalized delegations of legislative power." See *Industrial Union Department* v. *API*, 448 U.S. 607, 675 (1980) (Rehnquist, J., concurring in the judgment). Construed as it was by the court below to permit FTC intervention in the marketplace to afford consumers a more favorable "mix" of credit options, Section 5 would constitute an impermissibly "open-ended grant" of unguided legislative power, *id.* at 646 (plurality opinion) — a delegation to an Executive Branch agency of "the 'hard policy choices' properly the task of the legislature." *American Textile Manufacturers Institute, Inc.* v. *Donovan*, 452 U.S. 490, 543 (1981) (Rehnquist, J., joined by Burger, C.J., dissenting).

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hold goods collateral — the FTC insisted that lenders have no incentive to compete with each other for customers by offering credit without requiring household goods to be pledged, on the ground that those lenders who did so would be "likely to attract a disproportionately greater share of those debtors who intend to or who are most likely to default." (Pet. App. 36a) AFSA strenuously objected to the FTC's willingness to rely on signalling to support a finding of market failure while refusing to accept signalling as evidence of the value to lenders of pledges of household goods collateral. Judge Tamm was critical of the FTC's logic on this point (see Pet. App. 78a-79a.), as he was of other telling inconsistencies in the FTC's reasoning. See p. 11, n.15, above.

"Once it is accepted that the government can intercede between consumers and sellers whenever intervention can produce 'better' purchasing decisions, no obvious stopping-place can be found." Reich, *supra*, at 13.[19]

One cannot responsibly quarrel with the FTC's 1980 Policy Statement definition of "unfairness." As the Court of Appeals noted, the statement enjoys some congressional sanction. (See Pet. App. 21a & n.14) But it must be recognized that the 1980 Policy Statement, though described by the court below as a "refinement" of the description of "unfairness" factors quoted by this Court in the *S&H* case (see pp. 5-6, n.5, above), in fact is a substantial departure from that description, with its common sense view that whether an act or practice is unfair has something to do with whether it "offends public policy as it has been established by statutes, the common law or otherwise . . . . " (See Pet. App. 22a) The near abandonment of the public policy standard heightens the risk of FTC intervention to help consumers who are not being unfairly hurt.

The giving and taking of household goods as security for loans has been a subject of public policy debate at least since the National Commission on Consumer Finance recommended in 1972 that the practice be prohibited. Consumer protection laws and consumer credit laws in particular have been the subject of lively consideration in all or most states in the intervening years. Some states, on such consideration, have prohibited the taking of household goods as security; others have restricted the use of the device. But many states have elected to continue to sanction the use of household

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[19] As Judge Friendly has written:

> "We still live under a Constitution which provides that 'all legislative Powers herein granted shall be vested in a Congress of the United States [. . .]'; even if a statute telling an agency 'Here is the problem: deal with it' be deemed to comply with the letter of that command, it hardly does with the spirit."

H. Friendly, *The Federal Administrative Agencies: The Need for Better Definition of Standards* 21-22 (1962) (footnote omitted).

goods as security for consumer loans. Their action reflects, one must assume, a continuing interest in enabling the consumer who is otherwise a poor credit risk to borrow.

Certainly there is no such consensus that household goods security offends public policy as the FTC's 1964 statement quoted in this Court's *S&H* opinion implies that there must be to justify characterizing a practice as "unfair." When the absence of any such consensus becomes irrelevant to the FTC's determination of what is unfair, and the determination turns instead on a study of how consumers fare in the market, the risk surely is that the FTC will be tempted to enact *its* public policy and to intervene if consumers (or some consumers) are not faring as well as the FTC thinks they should — even though there is no seller (or, in this case, lender) overreaching or other interference with consumer choice.

We do not question Congress's power to grant the FTC broad authority to define "unfairness" under Section 5, and we do not contend for any judicially imposed limitation on that authority that would confine the definition to "fixed and unyielding categories." *FTC* v. *R.F. Keppel & Bro., Inc.*, 291 U.S. 304, 310 (1934). But broad discretion does not mean unlimited discretion, and we submit that it would not be unduly constricting to require — indeed, it would be entirely consistent with the FTC's own stated view of its Section 5 power to require — *some* finding of seller overreaching or other interference with free and informed consumer choice before an act or practice may be branded "unfair" under Section 5. Unless such a finding is required, there is virtually no limit on the FTC's discretion to intervene in the marketplace. Such unlimited discretion is beyond the power of Congress to delegate consistent with Article I, Section 1.

2. Review is also warranted to clarify the breadth of the FTC's remedial power under Section 18(a)(1)(B). With respect to the use of household goods as collateral, the *only* lender abuses identified on the record of these proceedings were instances in which a lender had reportedly used his security interest in a consumer's household goods to apply

undue pressure on a consumer to repay a loan. (Pet. App. 28a-29a & n.19) Examples of unfair pressure included a lender's reported threat to take furniture from a welfare family with eight children (Pet. App. 181a n.48) and a lender's reported appearance with a moving van at another consumer's front door, threatening to "empty the house." (Pet. App. 183a n.55) With respect to the use of future earnings as collateral, no such lender abuses were identified — only the hardship to the consumer of a creditor's assertion of a claim to the consumer's earnings in the event of default. (Pet. App. 157a-162a)[20]

Instead of promulgating a rule that would shield borrowers from heavy-handed debt collection practices by lenders where household goods or future earnings are pledged as collateral, the FTC chose to prevent consumers from pledging such property as collateral *at all*. In upholding this sweeping exercise of the FTC's remedial powers under Section 18(a)(1)(B), the D.C. Circuit's decision in this case was inconsistent with its own earlier pronouncement that a rule promulgated under that authority "must at least have a 'reasonable relation to the unlawful practices found to exist.'" *American Optometric Ass'n* v. *FTC*, 626 F.2d 896, 911 n.8 (D.C. Cir. 1980) (quoting *Jacob Siegel Co.* v. *FTC*, 327 U.S. 608, 613 (1946)). More important, it conflicts with the decision of the Court of Appeals for the Second Circuit in *Katharine Gibbs*, where the Second Circuit held that a rule promulgated under Section 18(a)(1)(B) must be "limited in its scope" to preventing the abuses identified on the rulemaking record. [21]

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[20] The FTC did suggest that some creditors brandish the "threat" of asserting claims against a borrower's future earnings to obtain payment of outstanding loans (Pet. App. 161a), but the agency did not recognize any distinction between unfair "threats" and legitimate reminders. It treated both as equally "injurious" not because of what is said by the lender but because of what the FTC believes to be at stake for the borrower when household goods or future earnings are at risk.

[21] 612 F.2d at 664. In *Katharine Gibbs*, the FTC had sought to prevent high-pressure or deceptive sales and enrollment practices at vocational

(footnote cont'd)

To fashion a remedy that was rationally connected to specific unfair practices, the FTC in this case would have had first to specify — define, in the terms of Section 18(a)(1)(B) — the practices it found to be "unfair." See *Katharine Gibbs*, 612 F.2d at 661-62. The FTC seems to emphasize threats of seizure — the ambiguous transactions that the FTC's own Presiding Officer himself found hard to distinguish from legitimate reminders (see P.O. Report 158) — as, in its view, abusive and "unfair." If such threats were indeed its concern, it might have followed the example of the Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692-1692o, by writing a series of precise prohibitions and restrictions — *e.g.*, limiting the circumstances in which a creditor may *visit* the consumer's home to discuss repayment, providing that the creditor may call the consumer *only* to discuss repayment, providing that the creditor may call the consumer to discuss repayment only *before* (or after) the consumer has become delinquent, or restricting what the creditor may *say* to the consumer in discussing repayment. Or, if its concern extended to the very rare actual seizures as well as threats, the FTC could have done as AFSA proposed in a motion for reconsideration by forbidding seizure of pledged household goods in the absence of a court order, issued after notice.

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schools that resulted in the admission — and subsequent drop-out — of unsuitable students. The FTC sought to prevent these practices through a rule prescribing certain refund policies, making it financially unattractive for schools covered by the rule to accept a student who, *for any reason whatever*, was unlikely to finish the course in which he enrolled. The Second Circuit set that part of the rule aside on the ground that it was not "limited in its scope" to preventing the practices at which it was aimed, but instead "penalize[d] every vocational school for every student dropout, regardless of cause." 612 F.2d at 664. The court concluded that there was "no rational connection between the Commission's universally applicable refund requirements and the prevention of specifically described unfair and deceptive enrollment practices." *Id.* Here, all borrowers are penalized for the heavy-handed debt collection practices of some lenders, because rather than forbidding such practices in connection with the use of pledged household goods collateral, the FTC has outlawed the use of such collateral altogether.

What the FTC could not lawfully do is to "protect" those consumers who are victimized by abusive debt collection practices involving household goods pledged as collateral by prohibiting those consumers — and the vast majority of consumers who have no cause for complaint — from *securing* credit by pledging such property as collateral. When a remedy sweeps so broadly, it exceeds the FTC's authority to prevent "unfair" acts or practices under Section 18(a)(1)(B). Review is warranted to make clear that the Second Circuit's view of FTC's remedial power, rather than the D.C. Circuit's view, is correct — that such remedial power is limited to preventing the abuses identified in the rulemaking record. See Sup. Ct. R. 17.1(a).

3. Finally, review is warranted to determine the extent of the FTC's power under Section 18(a)(1)(B) to preempt state consumer-protection laws. The issue here, of course, is one of congressional intent. As the Court of Appeals acknowledged, Congress enacted Magnuson-Moss after considering legislation that would have given the FTC more positive preemptive power (Pet. App. 61a-62a n.41); and in passing Magnuson-Moss itself Congress made clear that "it did not intend for the FTC to occupy the field of consumer-protection or to gratuitously intrude on state or local enforcement activities." (*Id.*) Moreover, as Judge Tamm observed in dissent, "principles of federalism" dictate deference by the FTC to the states' exercise of their police powers, and in deciding whether to regulate, therefore, "the disruptive effect federal regulation would have upon state regulatory schemes must be considered." (Pet. App. 69a-70a n.2)

The FTC itself acknowledged the stringent regulation of wage assignments in those states that permit them (Pet. App. 151a-153a), but nevertheless proceeded to preempt on the remarkable ground that more narrowly tailored state-law restrictions "do not *always* offer adequate protection." (Pet. App. 153a) Yet in the only two states in which pledges of future earnings are significantly used as collateral in consumer loans, state consumer protection statutes comprehen-

sively protect borrowers against all of the abuses that the FTC associated with pledges of future earnings — while preserving their ability to use their earning power to obtain loans to satisfy present wants or needs.[22] In the face of clear evidence of an intention by Congress *not* to authorize the FTC

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[22] As originally fashioned and subsequently amended, Article 3-A of the New York Personal Property Law, dealing with wage assignments, comprehensively protects borrowers against all abuses that the FTC associates with pledges of future earnings while preserving their ability to use their earning power to obtain loans to satisfy present wants or needs:

(a) The statute requires ample notice to the borrower of what is happening both when the loan is made and when the pledge of future earnings is given and, following default, before his employer is notified and steps taken to realize on the pledge through payroll deductions. N.Y. Pers. Prop. L. §§ 46-c(a), (b); 46-e; 48.

(b) The latter notice includes a statement of the borrower's right to raise in a special kind of judicial proceeding any defense he may have to the underlying debt claim or to the wage assignment in particular. *Id.* § 48. In such a proceeding the court is empowered to give the consumer *pendente lite* relief. *Id.* § 47-e. The borrower is notified alternatively that he may send to the lender a simple notice asserting a defense. *Id.* § 48(3). On receipt of such a notice, the lender may not enforce the wage assignment until he obtains a court order on notice to the borrower. *Id.* § 48(4).

(c) No more than 10 percent of an employee's wages can be deducted each pay period to satisfy the wage assignment, *id.* § 48-a(2)(a), and no part of wages of less than $85 a week may be withheld. *Id.* § 48-b.

(d) Under Section 5252 of the New York Civil Practice Law an employer may not discharge or lay off an employee because a wage assignment has been served on the employer and is liable for damages if he does so; the employee may be reinstated.

In acting to preempt so carefully wrought a statutory scheme (and Illinois' comparable scheme, Ill. Ann. Stat. ch. 48, § 39.1-.11), the FTC has transgressed "the outer boundaries of its authority" of which the Court of Appeals spoke in *American Optometric Ass'n* v. *FTC*, 626 F.2d 896, 910 (D.C. Cir. 1980), and "infringed on that deference to the states' exercise of their police powers dictated by the principles of federalism." The FTC was cautioned that "[s]tate and local consumer protection efforts are not to be supplanted by this expansion of jurisdiction" when Congress, by the same Magnuson-Moss statute that confirmed its legislative rulemaking power, empowered it to act in cases merely "affecting commerce." S. Rep. No. 151, 93d Cong., lst Sess. 27 (1973). See H.R. Rep. No. 1107, 93d Cong., 2d Sess. 45 (1974) (quoted at Pet. App. 61a-62a n.41))

freely to supplant state and local consumer-protection efforts, the FTC may not gratuitously override such efforts as it did here. Its conclusion that it could do so here was manifestly unreasonable and contrary to its statutory mandate.

CONCLUSION

For the foregoing reasons, review should be granted.

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